Supreme Court, U. S.
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80-228
No. ——

IN THE
Supreme Court of the United States
OCTOBER TERM, 1980

SUBURBAN REALTY COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTION PRESENTED

Whether the court of appeals applied the correct legal standard in determining that real property disposed of by petitioner at a gain was property held by the petitioner primarily for sale to customers in the ordinary course of a trade or business within the meaning of Section 1221(1) of the Internal Revenue Code of 1954, as amended (26 U.S.C. § 1221(1)).

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No. ———

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SUBURBAN REALTY COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Suburban Realty Company, by and through its counsel, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (Appendix A, *infra,* pp. 1a-32a) is officially reported at 615 F.2d 171 (5th Cir. 1980). The Findings of Fact and Conclusions of Law of the district court (Appendix B, *infra,* pp. 33a-40a) are unofficially reported at 77-2 U.S.T.C. ¶ 9547 (S.D. Tex. 1977).

JURISDICTION

The court of appeals entered its judgment on April 7, 1980. Appendix C, *infra,* p. 41a. Mr. Justice Powell granted an extension of time within which to petition for a writ of certiorari to and including August 15, 1980. Appendix D, *infra,* p. 43a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

Section 1221(1) of the Internal Revenue Code of 1954, as amended (26 U.S.C. § 1221(1)), provides as follows:

> SEC. 1221 CAPITAL ASSET DEFINED.
>
> For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—
>
> (1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.
>
> * * *

STATEMENT

Petitioner Suburban Realty Company ("Suburban") was organized on November 5, 1937, under the laws of the State of Texas. On December 7, 1937, Mr. R. L. Blaffer, Mr. Joe Evans, Mr. S. P. Farish and Mr. Will Farish transferred to Suburban, in exchange for all of its stock, an undivided one-fourth interest in 1742.6 acres of land (the "property") situated around what presently is the intersection of Homestead Road

and the North Loop in Harris County, Texas. These individuals had acquired the property through a foreclosure proceeding on bonds held by them and secured by the property.[1]

The following year (1938), the owners of the property organized Houston Gardens Annex, Inc. ("Houston Gardens") in order to facilitate the sale of a certain portion of the property (the "H. G. Section"). Suburban, Mr. Hamman and Mrs. Talbot transferred their respective interests in the H. G. Section to Houston Gardens in exchange for proportionate shares of that company's common stock. The H. G. Section was then subdivided and sold, principally to builders in quantities ranging from 20 to 50 lots. By 1961, Houston Gardens had sold all but two of its lots, and it was then liquidated. Houston Gardens never engaged in advertising, never established a sales organization, and never used or employed brokers or sales agents throughout its existence. The H. G. Section was at all times held by Houston Gardens, a separate corporation and a separate taxpayer, in which petitioner had only a 25 percent interest. App. A, at pp. 5a-6a; App. B, at pp. 35a-36a.

Another portion of the property located near its center was separately subdivided into four sections, designated as Homestead Addition Sections One, Two, Three and Four.[2] On July 10, 1948, Suburban acquired by exchange from the other property owners

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[1] The remaining three-fourths interest in the property was acquired at the same time by Mr. George Hamman (one-half) and Mrs. Mary Alice Talbot (one-fourth). App. A, at p. 2a, n.2.

[2] Little was done with Homestead Addition Section One except for platting and bringing in some utility lines. App. A, at p. 6a. Homestead Addition Sections Three and Four were platted

100 percent ownership of Homestead Addition Section Two. The area was platted and subdivided into 256 lots; streets and sewers were put in; and a sewage disposal plant was built nearby. The water and sewer system was maintained by a utility company which had been organized by Suburban, Mr. Hamman and Mrs. Talbot. Suburban built a lumberyard in Section Two. In addition, at the instance of one of the individuals whom Suburban hired to collect water bills and notes on houses and to manage the lumberyard, Suburban built eleven houses in Section Two in the early 1950's. The last was built by 1955 and none was sold later than 1958. App. A, at pp. 6a-7a; App. B, at p 36a.

Between 1948 and 1966, Suburban sold 252 subdivided lots in Section Two. About half of these lots were sold in bulk to builders—10, 15, or 20 lots at a time. The rest were sold to residential customers. In 1961, the water and sewer systems were sold by the utility company to the City of Houston and the utility company was liquidated. The lumberyard was sold in 1952 after having remained dormant for several years. The last sale of a subdivided lot from Section Two was made in Suburban's fiscal year ending October 31, 1966.[3]

No other improvements or development took place with respect to the balance of the property. A portion

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for residential use by Suburban and the other owners in 1951; however, this area was never developed by them. In 1961, the plats were withdrawn and cancelled. Subsequently, the real estate within Sections Three and Four was sold to commercial and industrial users. App. A, at p. 7a; App. B, at p. 36a.

[3] *See* App. A, at pp. 6a-7a; App. B, at p. 36a. The last sale to a residential customer occurred during the fiscal year ending October 31, 1959. App. A, at p. 32a.

of it was subject to a grass lease for many years. Two distinct parcels were sold by Suburban and the other owners in 1959 and 1960 to the Texas Highway Department for the purpose of constructing a limited access highway known as the North Loop. App. A, at p. 5a. All other parcels sold from the unimproved balance, and the dates of sale, are listed in an Appendix to the opinion of the court of appeals. App. A, at pp. 31a-32a.

Starting no later than 1959, Suburban's officers, directors and stockholders began discussing liquidation of Suburban. In 1961, Rice University became a stockholder of Suburban and the University's Treasurer became a member of the board of directors. Thereafter, because Rice University expressed a strong interest in investing in income-producing assets rather than in raw land, the liquidation of Suburban's real estate holdings, with a partitioning of those holdings among the stockholders, was actively considered. Even though this step was not taken, Suburban did reorient its investment activity. In 1966, it concluded the last sale of a residential lot in which Suburban had any interest, and began to make substantial investments in stocks and bonds; these investments started producing a sizeable income for the company. App. A, at p. 5a.

During Suburban's fiscal years ending October 31, 1969, 1970 and 1971, the company, together with the other owners, made a total of 8 sales to commercial purchasers of portions of the unimproved balance of the property. App. A, at p. 32a.[4] The five transactions

[4] The only disposition in 1970 was to the City of Houston under the threat of a condemnation. R. 89 ("R." references are to the Record Appendix on appeal).

which form the basis for the present dispute were among those sales. Six parcels of land were involved, each one subject to a grass lease at the time of disposition. App. A, at p. 3a.

Suburban originally treated the revenues it received from the eight sales last mentioned as ordinary income for federal tax purposes. However, the company subsequently filed a timely claim for refund with the Internal Revenue Service ("IRS") asserting that the nine tracts involved in these eight sales were capital assets and that the profits therefrom were entitled to capital gain treatment. The IRS granted Suburban's claim as to the final three sales, occurring after April 14, 1971; it denied the refund claim (totalling $102,754.50) relating to the other five sales. App. A, at p. 3a; R. 279, 322.

Suburban then instituted a suit for refund in the United States District Court for the Southern District of Texas pursuant to 26 U.S.C. § 1346. Following a non-jury trial, the district court ruled against Suburban and entered judgment dismissing the complaint. App. B, at pp. 33a-40a. On appeal, the United States Court of Appeals for the Fifth Circuit affirmed. App. A, at pp. 1a-32a.

REASONS FOR GRANTING WRIT

The Decision Below Erroneously Denies Capital Gain Treatment With Respect to the Disposition of an Undivided One-Fourth Interest in Unimproved Real Property Held by Taxpayer for More Than 30 Years Prior to Sale

In *Malat* v. *Riddell,* 383 U.S. 569 (1966), this Court resolved how the term "primarily", as used in Section 1221(1) of the Internal Revenue Code of 1954, as amended (the "Code"), is to be interpreted for pur-

poses of determining whether real property is "held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." 26 U.S.C. § 1221(1). What was not decided by the Court in *Malat,* however, and remains today a source of considerable confusion in the lower federal courts, is the proper timeframe in which to examine under Section 1221 (1) the taxpayer's "primary holding purpose" with respect to the real property in question.

This issue was squarely presented to the court below, and wrongly decided. In at least two important respects the Fifth Circuit has parted company with other federal courts: *first,* by holding that the proper timeframe for inquiring into the taxpayer's primary holding purpose is over the entire period during which he has held the property, rather than at or around the time of sale; and, *second,* by holding that it makes little difference under the referenced Code provision that the sale occurs independently from, and well after the cessation of, the taxpayer's activities associated with an earlier and unrelated real-estate-sales trade or business. By casting the legal standard for determining capital gain treatment in terms of the full history of the taxpayer's activities, rather than focusing on the status of the property itself upon disposition, the court of appeals effectively divorced from its analysis any meaningful consideration of the actual circumstances existing at the time of sale.

This approach further confounds the mixed, and often conflicting, responses given by the federal courts as to when real property constitutes a capital asset within the meaning of Section 1221(1) of the Internal Revenue Code. Guidance and clarification from the Supreme Court is sorely needed, both to assist taxpay-

ers in the planning of their affairs, and to insure a consistent and uniform application of the revenue laws. Review of the instant case on writ of certiorari is therefore required.

In denying Suburban's claim for a tax refund, the Fifth Circuit determined that the company's undivided one-fourth interest in six parcels of unimproved real property was not a capital asset at the time of the sales—even though Suburban had held its interest uninterrupted for some 30 years prior to the sales, had no sales employees, agents or real estate brokers working for or on behalf of the company at the time of the sales (or, indeed, for several years prior thereto), had engaged in no sales solicitation and, as a "minority" owner, did not even have any meaningful control over the disposition of the property, and had reinvested the proceeds in investment media other than real property.

To reach its result, the court of appeals adopted a novel legal standard that favors past activities over contemporaneous circumstances. Thus, according to the Fifth Circuit, if it can be shown that the taxpayer at any time during the course of his ownership of the questioned property held other adjacent property primarily for sale as part of a trade or business, capital gain treatment can be denied as to later unrelated property sales by the taxpayer, even after the identified trade or business has been discontinued.[5] This is

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[5] There is no dispute that other property held by Suburban and other co-owners was transferred to a separate corporation, Houston Gardens, Inc., in 1938, and thereafter developed and sold to both builders and residential customers. See p. 3, *supra*. It is highly questionable whether Suburban which had only a 25 percent stock interest in Houston Gardens and acted as sales manager for the disposition of this real property, should have imputed to it the trade or business of Houston Gardens for pur-

so, the court below stated, since "[t]he statutory language does not demand that property actually be sold while a taxpayer is still actively engaged in its trade or business for ordinary income treatment to be required." App. A, at p. 21a.

Such a holding runs counter to the plain meaning of the statute itself, which requires that the property be sold in the regular course of a trade or business for the proceeds therefrom to be considered as ordinary income. 26 U.S.C. § 1221(1). As this Court admonished in *Malat* v. *Riddell, supra,* 383 U.S. at 571, the words of the revenue acts should be interpreted where possible in their "ordinary, everyday senses." Other circuit court and tax court decisions, in apparent recognition of this basic principle of statutory construction, have thus afforded taxpayers capital gain treatment with respect to property sales made after a demonstrated change in the holding purpose, or, alternatively, with respect to property sales associated with

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poses of determining the holding purpose with respect to other assets, as the Fifth Circuit apparently determined. App. A, at pp. 24a-25a. Compare *Moline Properties Inc.* v. *Commissioner of Internal Revenue,* 319 U.S. 436 (1943); *Buono* v. *Commissioner of Internal Revenue,* 74 T.C. —— (No. 15) (April 29, 1980); and see generally *Alabama Mineral Land Co.* v. *Commissioner of Internal Revenue,* 250 F.2d 870 (5th Cir. 1957).

In any event, the record shows without contradiction that Houston Gardens terminated its real estate activity by 1961. While Suburban engaged in some real estate development activity with reference to another portion of the property identified as Homestead Section Two between 1948 and 1966, the last sale of Section Two lots took place during Suburban's fiscal year ending October 31, 1966. R.19. Suburban engaged in no development-type activity for at least 3 years preceding the sales here in question. Since 1966 Suburban's attention was redirected toward investing in securities and other income-producing assets, rather than in real estate (p. 5, *supra*).

separate holding purposes independent of the taxpayer's real estate business. See *Municipal Bond Corporation* v. *Commissioner of Internal Revenue,* 383 F.2d 184 (8th Cir. 1967); *Scheuber* v. *Commissioner of Internal Revenue,* 371 F.2d 996 (7th Cir. 1967); *Maddux Construction Co.* v. *Commissioner of Internal Revenue,* 54 T.C. 1278 (1970); *Olivieri* v. *Commissioner of Internal Revenue,* 25 T.C.M. 920 (1966). These cases rejected—as did even the Fifth Circuit prior to the instant decision—the proposition that "one's usual trade or business necessarily freezes all of [a taxpayer's] dealings inevitably within the framework of that calling." *Smith* v. *Commissioner of Internal Revenue,* 232 F.2d 142, 144-145 (5th Cir. 1956). The decision below is in direct conflict.

The Fifth Circuit seems to have reached its erroneous determination because it focused its inquiry into the taxpayer's "primary holding purpose" upon a timeframe which extended "over the entire course of [the taxpayer's] ownership of the property." App. A, at p. 24a. This approach is clearly in error and cannot be reconciled with the standard utilized by other federal courts which have held that the relevant timeframe for ascertaining the primary holding purpose is at or around the time of sale. See *Commissioner of Internal Revenue* v. *Tri-S Corporation,* 400 F.2d 862 (10th Cir. 1968); *Maddux Construction Co.* v. *Commissioner of Internal Revenue, supra; Eline Realty Company* v. *Commissioner of Internal Revenue,* 35 T.C. 1 (1960).

Had the above authorities been followed, the result below would have been different. Even assuming that real estate sales by Suburban and others, occurring years earlier and under very different circumstances,

involved lots which had then been held primarily for sale by the owners in the ordinary course of a trade or business, it remains uncontested that the real estate activity which would have supported such a conclusion ended at the very latest in 1966. See n.5, *supra.* Thereafter, and particularly during Suburban's fiscal years ending October 31, 1969, 1970 and 1971, the property sales by Suburban and the other co-owners were neither "frequent" nor "substantial."[6]

Each of the six tracts involved in this case was undeveloped land that was at the time of sale subject to a grass lease. App. A, at p. 3a. The property in question had been held by the owners for more than 30 years and at no time throughout that period had it even been proposed or considered for sale. *Id.*[7] All gains realized from the questioned transactions were

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[6] Between 1939 and 1945, average sales were approximately 3 per year. Between 1946 and 1959, "residential" sales greatly exceeded "commercial" sales, and total sales were approximately 13 per year. After 1959, the average sales per year dropped to 3 and all sales were "commercial." App. A, at pp. 31a-32a. With reference to the five disputed transactions, 3 occurred in Suburban's fiscal year ending October 31, 1969, one occurred during the 1970 fiscal year, and that was under threat of condemnation by the City of Houston (see n. 4, *supra*), and the other occurred during Suburban's 1971 fiscal year. App. A, at p. 3a, n.4. The six parcels of land involved totalled just over 44 acres. *Id.*

[7] As already noted, the sale that occurred in Suburban's 1970 fiscal year was made under threat of condemnation. The lower courts are divided over what impact, if any, a notice of condemnation has upon the taxpayer's "holding purpose." Some courts have held that receipt of a notice of condemnation has no necessary effect (*McManus* v. *Commissioner of Internal Revenue*, 583 F.2d 443 (9th Cir. 1979), *affirming* 65 T.C. 197 (1975), *certiorari denied*, 440 U.S. 959 (1979); *Juleo, Inc.* v. *Commissioner of Internal Revenue*, 483 F.2d 47 (3d Cir. 1973), *reversing* 30 T.C.M. 284 (1971), *certiorari denied*, 414 U.S. 1103 (1973)), while others have allowed the

due solely to appreciated land values, and not to any real estate activity or other efforts on the part of the owners. None of the proceeds were used to repurchase real property; instead they were used to purchase securities consistent with Suburban's practice since 1966, when Rice University became a shareholder and insisted upon "investments in income-producing assets rather than raw land." App. A, at p. 5a.

If the Fifth Circuit had focused on the particular property which is the subject of taxation, as required by 26 U.S.C. § 1221, rather than on the entire history of the taxpayer's activities over more than a 30-year period, it would have had no difficulty concluding that proceeds from the sales in question were attributable to precisely what this Court recognized in *Malat* v. *Riddell, supra,* 383 U.S. at 572, as the benchmark for capital gain treatment, to wit: "the realization of appreciation in value accrued over a substantial period time," quoting *Commissioner of Internal Revenue* v. *Gillette Motor Transport, Inc.,* 364 U.S. 130, 134 (1960).[8] Regrettably, by going through a tortured an-

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notice to work virtually an automatic change in the holding purpose for Section 1221(1) analysis. *Ridgewood Land Co.* v. *Commissioner of Internal Revenue,* 31 T.C.M. 39 (1972), *affirmed per curiam,* 477 F.2d 135 (5th Cir. 1973); *Tri-S Corporation* v. *Commissioner of Internal Revenue,* 48 T.C. 316 (1967), *affirmed;* 400 F.2d 862 (10th Cir. 1968); *see also Morrison* v. *United States,* 449 F.Supp. 663 (N.D. Ohio, 1978), *appeal pending* (6th Cir.); *Biedermann* v. *Commissioner of Internal Revenue,* 68 T.C. 1 (1977). The Fifth Circuit's disregard for the condemnation notice in this case aligns it with both the Third Circuit and the Ninth Circuit, but puts it in conflict with the Sixth and Tenth Circuits.

[8] As this Court recognized in *Corn Products Refining Co.* v. *Commissioner of Internal Revenue,* 350 U.S. 46, 52 (1955), the central legislative purpose for granting favorable tax treatment to

alysis that placed undue emphasis on earlier real estate transactions unrelated both in time and proximity to the sales involved here,[9] the court below confounded the general guidelines announced by this Court in *Malat* v. *Riddell*, established a troublesome precedent which undermines the statutory purpose for affording taxpayers capital gain treatment as to certain sales not made in the ordinary course of a trade or business (see, n. 8, *supra*), and reached a result which is in direct conflict with decisions of other federal courts and the tax court. See pp. 8-10, *supra*.

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gains resulting from long-term appreciation was to ameliorate the hardship which otherwise would result from taxing the entire long-term gain in one year, the so-called "bunching effect."

[9] Curiously, three related sales occurring subsequent to April 14, 1971, were afforded capital gain treatment in response to Suburban's claim for refund. See p. 6, *supra*. The only apparent basis in the record for the Revenue Service to distinguish these sales from the five at issue here is a statement appearing in the minutes of Suburban's directors' and shareholders' meeting on May 18, 1971, urging consideration of a liquidation of the corporation and formation of a limited partnership to hold the remaining real estate. R. 322. However, the record clearly shows that such a course of action was considered by Suburban's directors and shareholders as early as 1959 (R. 25); that in 1961 actual steps were taken to remove from existing development plans certain of the real estate theretofore slated for development (see n. 2, *supra*); and that in 1966, Suburban ceased altogether investing in new land and commenced instead a securities investment program (see p. 5, *supra*). These various events argue at least as strongly as the May 18, 1971 statement that the five transactions here in question were similarly entitled to capital gain treatment.

CONCLUSION

For the reasons stated, the instant petition for a writ of certiorari should be granted.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit was served on the United States of America by mailing a copy of same to M. Carr Ferguson, Esquire, Assistant Attorney General, Tax Division, Department of Justice, Washington, D.C. 20530, by first class mail, postage prepaid, on this 15th day of August, 1980.

WM. BRADFORD REYNOLDS

APPENDIX A

APPENDIX A

SUBURBAN REALTY COMPANY,
Plaintiff-Appellant,

v.

UNITED STATES OF AMERICA,
Defendant-Appellee.

No. 77-3094.

United States Court of Appeals,
Fifth Circuit.

April 7, 1980.

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Gerald W. Haddock, Charles W. Hall, Houston, Tex., for plaintiff-appellant.

M. Carr Ferguson, Asst. Atty. Gen., Tax Div., Gilbert E. Andrews, Act. Chief, Appellate Section, Richard Farber, Atty., Marilyn E. Brookens, Tax Div., Dept. of Justice, Washington, D. C., for defendant-appellee.

Appeal from the United States District Court for the Southern District of Texas.

Before GOLDBERG, FAY and ANDERSON, Circuit Judges.

GOLDBERG, Circuit Judge:

We must today answer the riddle at once adumbrated and apparently foreclosed by the false dichotomy created by the United States Supreme Court in *Malat v. Riddell,* 383 U.S. 569, 572, 86 S.Ct. 1030, 1032, 16 L.Ed.2d 102 (1966) (per curiam): when profits have "aris[en] from the [ordinary] operation of a business" on the one hand and are *also* "the realization of appreciation in value over a substantial period of time" on the other, are these profits treated as ordinary income or capital gain? Lacking any

clear guidance but the language of the capital asset statute [1] itself, we turn to that language for the answer. Before we can arrive at this interesting and important question, however, we must once again tramp along (but not trample on) that time- and precedent-worn path which separates capital gains from ordinary income. By the time we emerge into the light at the far edge of the forest, we will find that the *Riddell* riddle has seemingly answered itself, and all that will remain will be a brief reassessment of our answer. In our peregrinations, we of necessity wander into virgin territory. We hope that we shed new light onto this murky terrain; at the least, we think we have neither riddled the cases nor muddled the issues.

I.

Suburban Realty Company was formed in November, 1937, to acquire an undivided one-fourth interest in 1,742.6 acres of land located in Harris County, Texas ("the property"). Suburban received its interest [2] in the property in exchange for all of its stock from four individuals [3] who had themselves acquired the property in a foreclosure proceeding brought against the property as a result of a default in the payment of certain bonds, the payment of which was secured by the property. Suburban's corporate charter states that it was formed to erect or repair any building or improvement, and to accumulate and lend money for such purposes, and to purchase, sell, and

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[1] 26 U.S.C. § 1221.

[2] The remaining three-fourths undivided interest was held by two individuals who acquired their interest at the same time that Suburban's shareholders acquired their interest. Mr. George Hamman owned an undivided one-half interest, which ultimately passed to the Hamman Foundation. Mrs. Mary Alice Talbot owned the remaining undivided one-fourth interest.

[3] Mr. R. L. Blaffer, Mr. Joe Evans, Mr. S. P. Farish, and Mr. Will Farish.

subdivide real property, and to accumulate and lend money for that purpose.

The five transactions whose characterization is in dispute here concern six tracts of unimproved real estate sold from the property by Suburban between 1968 and 1971.[4] On its tax returns, Suburban originally reported profits from these sales, as well as all of its other real estate sales, as ordinary income. Later, Suburban filed a claim for refund asserting that these six tracts, as well as three similar tracts sold later, were capital assets, and that profits from these sales were entitled to capital gains treatment. The Internal Revenue Service denied Suburban's claim as to the sales here in issue.[5] Suburban then instituted this action for a refund of $102,754.50. The district court, in a non-jury trial, rendered a decision against Suburban and entered a judgment dismissing Suburban's complaint. Suburban appealed.

The parties' legal contentions are closely bound to the facts. It is undisputed that, at the time of sale, the tracts at issue here were subject to a grass lease which apparently covered much of the property. Except for this grass lease, the six tracts, as well as much of the rest of the property, were never put to any substantial use. However, certain other portions of the property were the subject of greater activity. The parties disagree to some degree con-

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[4] The parties stipulated that the sales were as follows:

Date	Acreage	Sales Price
December 31, 1968	4.5	$ 56,250
July 31, 1969	6.25	93,285
July 31, 1969	6.0225	90,225
July 31, 1969	17.50	262,282
1970 [*sic*]	5.6944	39,799
April 14, 1971	4.375	65,675

[5] The government allowed Suburban's claim with respect to the three tracts sold later, and refunded $70,377.79.

cerning the extent of, and appropriate characterization of, the activities conducted relating to these other portions of the property, and they fundamentally dispute the weight such activities carry in properly characterizing the sales at issue here. We will first discuss Suburban's overall activities with respect to the entire property, and then turn to those portions of the property singled out by the parties as being the subject of greater activity.

A. Overall activities.

1. *Total Sales Activity From the Property.*

Between 1939 and 1971, Suburban made at least 244 individual sales of real estate out of the property. Of these, approximately 95 sales were unplatted and unimproved property legally suitable for commercial development for any other purpose,[6] and at least 149 sales were from platted property restricted to residential development.[7] In each of these 33 years, Suburban concluded at least one sale; in most years, there were four or more sales. Suburban's total proceeds from real estate sales over this period were $2,353,935. Proceeds from all other sources of income amounted to $474,845.[8] Thus, eighty-three percent of Suburban's proceeds emanated from real estate sales; only seventeen percent flowed from all other sources.

2. *North Loop Freeway.*

In 1957, the Texas Highway Department proposed that the limited access superhighway now known as the North

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[6] There is no zoning in the City of Houston. Land use restrictions are ordinarily accomplished by placing restrictive covenants in the chain of title to the land.

[7] See Appendix, *infra*.

[8] This includes dividend income ($54,165), rent and lease income ($15,732), and sales of lumber from its lumber yard ($11,939). The source of the remaining proceeds, approximately $400,000, is not apparent.

Loop would be located from east to west across the property. In 1959 and 1960, Suburban sold at least two parcels out of the property to the Texas Highway Department for the purpose of constructing this highway. The location of the highway had a dramatic effect on the price of land in the area. Land which had been selling for between three and five thousand dollars per acre prior to announcement of the highway rose in value to between seven and twelve thousand dollars per acre.

3. *Corporate Discussions and Investments.*

Starting not later than 1959, Suburban's officers, directors and stockholders began discussing liquidation of the corporation. Many of these discussions occurred after 1961, when Rice University became a stockholder of Suburban and the Treasurer of Rice University became a member of the board of directors. Because Rice University desired investments in income-producing assets rather than raw land, discussions concerning liquidation [9] of Suburban's real estate holdings and the possibility of a partition of its holding among its stockholders [10] were common. Starting in 1966, Suburban made substantial investments in stocks and bonds and began receiving substantial income from these investments.

B. Specific portions.

1. *Houston Gardens.* In 1938, Suburban and the other owners of the property formed a separate corporation, Houston Gardens Annex, Inc. ("Houston Gardens"), to plat and sell a parcel in the northeast quadrant of the

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[9] Appellant uses the term "liquidation" to refer to "winding up of a corporate entity" and "conversion of assets into cash," as well as the "liquidation niche" left open by *Biedenharn Realty Co., Inc. v. United States,* 526 F.2d 409, 417 (5th Cir.) (en banc), *cert. denied,* 429 U.S. 819, 97 S.Ct. 64, 50 L.Ed.2d 79 (1976).

[10] This was never carried out because of the difficulty of achieving an equitable division.

property. The stock ownership in Houston Gardens was in the same proportion as ownership interests in the property —i.e., Suburban and Mrs. Talbot each owned one-quarter of the stock of Houston Gardens; Mr. Hamman owned one-half of the stock. Houston Gardens owned approximately 200 or 250 lots, which were generally sold in bulk to builders. These sales covered as many as 20, 30, or even 50 lots at a time. By 1961, Houston Gardens had sold all but two of its lots, and it was then liquidated. Houston Gardens never engaged in advertising, used brokers or real estate agents, or employed a sales organization at any time during its existence.

2. *Homestead Addition.* Certain portions of the property, located near its center, were designated as Homestead Addition Sections One, Two, Three, and Four. Little was done with Homestead Addition Section One except for platting it and running a few utility lines up to it.

Homestead Addition Section Two, however, was the primary subject of Suburban's activities. In July, 1948, Suburban acquired 100 percent ownership of Homestead Addition Section Two by exchanging cash and other land for the other owners' interests. Immediately thereafter, Suburban commenced development of Homestead Addition Section Two. The area was platted, streets and sewers were put in, and a sewage disposal plant was built nearby.[11] Suburban also built a lumberyard in Section Two.[12] At the instance of one of the individuals whom Suburban hired to collect water bills and notes on houses and to manage the lumberyard, Suburban also built eleven houses in Section Two in the early 1950's. The last was built by 1955, and none was

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[11] A utility company was formed by Suburban, Mr. Hamilton, and Mrs. Talbot to maintain the water and sewage system. By 1961, the system had been sold to the City of Houston, and the utility company was liquidated.

[12] In 1961 or 1962, the lumberyard was sold, having already been dormant for some years.

sold later than 1958.[13] Between 1948 and 1966, Suburban sold 252 subdivided lots out of Section Two. About half of these lots were sold in bulk to builders—10, 15, or 20 lots at a time.[14]

Homestead Addition Sections Three and Four were platted for residential use by Suburban in 1951. This area was never developed by Suburban, however. In 1961 the plats were withdrawn and cancelled. This had the effect of eliminating restrictions which prevented commercial use of the land. Subsequently, the real estate within Sections Three and Four was sold to commercial and industrial users.

3. *Other Parcels.* The remainder of the property appears to have been treated as one undifferentiated bulk by Suburban. It is from this undifferentiated, undeveloped remainder that the sales at issue here were made. There are no specific findings by the trial court, and there appears to be no evidence of record from which we could ourselves make findings, concerning the number and frequency of sales of real estate from other parts of the property. Rather the evidence concerning annual sales groups all sales made by Suburban, including sales from the Homestead Addition Sections, together.[15] However, it is clear that throughout the period 1939-1971, sales were being made from the remainder of the property.

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[13] The evidence conflicts concerning whether the last house was sold in 1955, 1956, or 1958. The court below implicitly found that the last house was sold in 1956. We attach no significance to the precise year in the context of this case.

[14] There is no finding by the court below, or any record evidence that we can locate, concerning the number of individual transactions employed to sell the 252 lots. This lack of evidence may be attributable to Suburban's failure to record separately transactions from the various Homestead Addition Sections or even to separate Homestead Addition sales from non-Homestead sales. Alternatively, the paucity of evidence may merely reflect incompleteness of the records submitted to the district court.

[15] See n. 14, *supra.*

II.

Our analysis of this case must begin with *Biedenharn Realty Co., Inc. v. United States*, 526 F.2d 409 (5th Cir.) (en banc), *cert. denied*, 429 U.S. 819, 97 S.Ct. 64, 50 L.Ed. 2d 79 (1976). *Biedenharn* is this Court's latest (and only) *en banc* pronouncement concerning the characterization of profits of a real estate business as ordinary income or capital gain. The decision answers the characterization question by evaluating certain "factors" often present in cases of this ilk.[16] *Biedenharn* attempts to guide the analysis in this area by assigning different levels of importance to various of the "factors." Substantiality and frequency of sales is called the most important factor. *Biedenharn*, 526 F.2d at 416. Improvements to the land, solicitation and advertising efforts, and brokerage activities also play an important part in the *Biedenharn* analysis.

The question before us today, put into the *Biedenharn* framework, can be stated as follows: when a taxpayer engages in frequent and substantial sales over a period of years, but undertakes no development activity with respect to parts of a parcel of land, and engages in no solicitation or advertising efforts or brokerage activities, under what circumstances is income derived from sales of undeveloped parts of the parcel ordinary income?

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[16] In the *United States v. Winthrop*, 417 F.2d 905, 910 (5th Cir. 1969), the following factors were enumerated:

> (1) the nature and purpose of the acquisition of the property and the duration of the ownership; (2) the extent and nature of the taxpayer's efforts to sell the property; (3) the number, extent, continuity and substantiality of the sales; (4) the extent of subdividing, developing, and advertising to increase sales; (5) the use of a business office for the sale of the property; (6) the character and degree of supervision or control exercised by the taxpayer over any representative selling the property; and (7) the time and effort the taxpayer habitually devoted to the sales.

The *Biedenharn* framework allows us to ask the question, but gives us little guidance in answering it. In the principal recent cases, there has always been a conjunction of frequent and substantial sales with development activity relating to the properties in dispute. *See, e. g., Houston Endowment, Inc. v. United States,* 606 F.2d 77, 82 (5th Cir. 1979), *Biedenharn,* 526 F.2d at 417; *United States v. Winthrop,* 417 F.2d 905, 911 (5th Cir. 1969). The conjunction of these two factors "will usually conclude the capital gains issue against [the] taxpayer." *Biedenharn,* 526 F.2d at 418. Judge Wisdom has recently written that "ordinary income tax rates usually apply when dispositions of subdivided property over a period of time are continuous and substantial rather than few and isolated." *Houston Endowment,* 606 F.2d at 81. Also, it has been explicitly stated that the factor which will receive greatest emphasis is frequency and substantially of sales over an extended time period. *See Biedenharn,* 526 F.2d at 417. However, substantial and frequent sales activity, standing alone, has never been held to be automatically sufficient to trigger ordinary income treatment. In fact, we have continual reminders of the fact that "specific factors, or combinations of them are not necessarily controlling, *Biedenharn,* 526 F.2d at 415, quoting *Thompson v. Commissioner,* 322 F.2d 122, 127 (5th Cir. 1963), *quoting Wood v. Commissioner,* 276 F.2d 586, 590 (5th Cir. 1960).

Each of the parties invites us to look back to a case from long ago for guidance. Suburban points to *Alabama Mineral Land Co. v. Commissioner,* 250 F.2d 870 (5th Cir. 1957). The Government points to *Thompson, supra.* Each claims that the case it cites is substantially identical on its facts to the one before us. Each is essentially correct.[17]

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[17] Were the presence of subdivision and development activity the critical fact mandating ordinary income treatment in these cases, Suburban's analogy of the instant case to *Alabama Mineral* would be closer than the Government's analogy to *Thompson.* However,

However, we again decline, as have the earlier cases, to attempt a case-by-case distinction. *See Houston Endowment,* 606 F.2d at 82, *Biedenharn,* 526 F.2d at 421; *Thompson,* 322 F.2d at 127. We merely note that the *Alabama Mineral* decision contains no analysis of whether "the antiquated purpose" (liquidation of property holdings) was "overborne by later, but substantial and frequent selling activity." *Biedenharn,* 526 F.2d at 421. Rather, the court simply characterized taxpayer's purpose for acquiring the property as "liquidation," and concluded that sales made in liquidation result in capital gain rather than ordinary income. *Alabama Mineral,* 250 F.2d at 872. *Biedenharn* tells us, however, that "investment purpose has no built-in perpetuity nor a guarantee of capital gains forever more [*sic*]." 526 F.2d at 421. Thus, the method of analysis used in *Alabama Mineral* has not survived *Biedenharn.*[18]

Today, we must go into territory as yet unmapped in this Circuit. Suburban's case is at once more favorable to the taxpayer than Biedenharn's and less so. It is more favorable because, *with respect to the particular parcels of land here at issue,* it is undisputed that Suburban undertook no development or subdivision activity. It is less favorable because Biedenharn was continually engaged in business activities other than real estate sales, whereas Suburban was for many years doing little else. Following the *Biedenharn* framework alone, we would be left with yet another essentially *ad hoc* decision to be made. We could justify a decision for either party, yet remain confident that we were being fully consistent with the analysis in *Biedenharn.* However, although there will always remain

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such a presumption assumes the answer to the question before us: whether subdivision and development activity is a *sine qua non* of ordinary income treatment.

[18] We also note that *Alabama Mineral* is not cited in the *Biedenharn* decision in its listing of earlier decisions which the *Biedenharn* court was "loath to overrule." *Biedenharn,* 526 F.2d at 421.

a certain irreducible *ad hoc*-ishness in this area, we are now firmly convinced that the uncertainty can be substantially reduced by turning to the divining rod of capital gains versus ordinary income—the statute itself.

III.

The jurisprudence of the "real estate capital gains-ordinary income issue" in this Circuit has at times been cast somewhat loose of its statutory mooring. The ultimate inquiry in cases of this nature is whether the property at issue was "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." 26 U.S.C.A. § 1221(1) (West 1967). In our focus on the "tests" developed to resolve this question, we have on occasion almost lost sight entirely of the statutory framework. The "tests" or "factors," whether they be counted to number seven, *see Winthrop,* 417 F.2d at 910, or to number four, *see Houston Endowment,* 606 F.2d at 81, have seemingly acquired an independent meaning of their own, loosely tied to their statutory pier. Some years ago, Judge Brown cautioned us against this tendency:

> Essential as they are in the adjudication of cases, we must take guard lest we be so carried away by the proliferation of tests that we forget that the statute excludes from capital assets 'property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.'

Thompson, 322 F.2d at 127. *See Biedenharn,* 526 F.2d at 424 (Roney, J., specially concurring).

The tendency to overemphasize the independent meaning of the "factors" has been accompanied by, perhaps even caused by, a tendency to view the statutory language as posing only one question: whether the property was held by the taxpayer "primarily for sale to customers in the ordinary course of his trade or business." This determi-

tion was correctly seen as equivalent to the question whether the gain was to be treated as ordinary or capital. However, probably because the question "is the gain ordinary" is a single question which demands an answer of yes or no, the courts have on occasion lost sight of the fact that the statutory language requires the court to make not one determination, but several separate determinations. In statutory construction cases, our most important task is to ask the proper questions. In the context of cases like the one before us, the principal inquiries demanded by the statute are:

1) was taxpayer engaged in a trade or business, and, if so, what business?

2) was taxpayer holding the property primarily for sale in that business?

3) were the sales contemplated by taxpayer "ordinary" in the course of that business? [19]

We by no means intend to suggest that we disagree with anything decided by the recent Fifth Circuit decisions. *Biedenharn* guides our decision-making process. But after the relevant three independent statutory inquiries are pried apart, it becomes apparent that the central dispute in *Biedenharn* was a narrow one: was Biedenhain Realty Company holding the land in dispute "primarily for sale?" The majority, applying the *Winthrop* factors, decided this question in the affirmative. The dissent, emphasizing the continuing farming activities being conducted by Bieden-

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[19] In other types of cases, or even in real estate cases with different factual patterns, other questions may be crucial. For example, whether the contemplated purchasers were "customers" of the taxpayers, or whether business activity is to be imputed to taxpayer so as to be considered "taxpayer's business," could be an important inquiry. Yet other inquiries may be demanded by the statutory language in other contexts. Here, the key questions are those set out above.

harn, *see Biedenharn*, 526 F.2d at 425 & n.5, 426 (dissenting opinion), disagreed as to this conclusion.[20]

In fact, once the inquiry is redirected towards the statutory inquiries, the ultimate relevance of the *Biedenharn* factors becomes apparent. It will remain true that the frequency and substantiality of sales will be the most important factor. But the reason for the importance of this factor is now clear: the presence of frequent and substantial sales is highly relevant to each of the principal statutory inquiries listed above.[21] A taxpayer who engages in frequent and substantial sales is almost inevitably engaged in the real estate business. The frequency and substantiality of sales are highly probative on the issue of holding purpose because the presence of frequent sales ordinarily belies the contention that property is being held "for investment" rather than "for sale." And the frequency of sales may often be a key factor in determining the "ordinariness" question.

The extent of development activity and improvements is highly relevant to the question of whether taxpayer is a real estate developer. Development activity and improvements may also be relevant to the taxpayer's holding purpose, but, standing alone, some degree of development activity is not inconsistent with holding property for pur-

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[20] It is also possible that the dissenters would have concluded that Biedenharn was not in the real estate business. *See Biedenharn*, 526 F.2d at 427 (dissenting opinion). However, the three inquiries identified today were not focused on separately by either the majority or the dissent. *Cf. Biedenharn*, 526 F.2d at 424 (concurring opinion of Roney, J.) (suggesting at least two inquiries mandated by statute).

[21] This truth is suggested in *Biedenharn:*

> The frequency and substantiality of Biedenharn's sales go not only to its holding purpose and the existence of a trade or business but also support our gnding of the ordinariness with which the Realty Company disposed of its lots.

526 F.2d at 416.

poses other than sale.[22] The extent of development activity also seems to be only peripherally relevant to the "ordinariness" question.[23] Thus, under the statutory framework, as under *Biedenharn,* the extent of development activity and improvements, although an important factor is less conclusive than the substantiality and frequency of sales.

Solicitation and advertising efforts are quite relevant both to the existence of a trade or business and to taxpayer's holding purpose. Thus, their presence can strengthen the cast for ordinary income treatment. *See Biedenharn,* 526 F.2d at 418. However, in cases like *Biedenharn,* their absence is not conclusive on either of these statutory questions for, as we noted there, "even one inarguably in the real estate business need not engage in promotional exertions in the fact of a favorable market." *Id.*

We need not comment individually on each of the other *Biedenharn-Winthrop* factors. It should be apparent that each factor is relevant, to a greater or lesser extent, to one or more of the questions posed by the statute along the path to the ultimate conclusion.[24]

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[22] For example, a taxpayer might clear trees and conduct some grading and filling activities in preparation for farming the land.

[23] We here must caution that we of course cannot contemplate all possible fact situations, and our suggestions concerning which factors are relevant to which questions may not be applicable to all fact patterns. The discussion here is intended merely to demonstrate the close relationship between the requisite statutory determinations and the *Biedenharn* factors.

[24] We will here attempt to clear up some of the confusion relating to the relevance of the percentage of taxpayer's average annual income attributable to real estate sales. This percentage has often been mentioned in the real estate cases; its significance has never been clear. *See, e. g. Houston Endowment,* 606 F.2d at 81 n.3; *Biedenharn,* 526 F.2d at 419; *id.* at 426 & n.7 (dissenting opinion); *Winthrop,* 417 F.2d at 907. Rather, these decisions have referred to the percentage, often compared it to the comparable percentage in another case, and perhaps noted that the percentage in the case being decided was like or unlike the percentage in another case.

IV.

Having laid the framework for the requisite analysis, we must now apply that framework to the facts here. We must decide whether Suburban was engaged in a trade or business, and, if so, what business; whether Suburban was holding the properties at issue here primarily for sale; and whether Suburban's contemplated sales were "ordinary" in the course of Suburban's business.

Once the percentage is related to the statutory inquiries, it can easily be seen that the percentage may or may not be relevant depending on the facts of the case and the taxpayer's claims. Two examples are appropriate here.

First, a taxpayer who has made only a few sales involving fairly modest dollar amounts may argue that he is not in the real estate business. The taxpayer's claim to capital gain treatment is likely to be weaker if he can point to no other business activities; i. e., if close to 100 percent of his income is derived from sales of real estate. Conversely, if the taxpayer is also engaged in extensive activities other than real estate sales, the presence of another trade or business may make it less likely that he will be found to be in the real estate business. However, frequent real estate activity substantial in dollar amount will likely conclude the "trade or business" question against taxpayer. He will be held to be engaged in both the real estate business and his other business. *See Biedenharn*, 526 F.2d at 419 & n.35.

The taxpayer's next argument will likely be that the property is held "primarily" for use in his other business (*e. g.*, farming) rather than "for sale." If a large percentage of his income *derived from the land in dispute* is earned other than by sale, his claim that his primary holding purpose is for use in his other business is buttressed. This would clearly be the case if a few small tracts of land were sold from a large active farm. Conversely, if most of the income derived from the land in dispute is earned from real estate sales, it is more likely that the taxpayer's primary holding purpose is "for sale."

In *Biedenharn*, the percentage offered was real estate sales as compared to total income. The fact that this percentage was low (11.1%), *see* 526 F.2d at 419, demonstrated that Biedenharn was engaged in businesses other than real estate (*e. g.*, securities investments). These other businesses did not relate to the property in

Before we commence this analysis, we must ascertain the appropriate standard of appellate review. Unfortunately, the hidden supposition that the statutory language poses only one question, *see* p. 178 *supra*, has caused great confusion [25] concerning whether the appropriate standard is "clearly erroneous" or "plenary review." This Circuit has often faced the question whether the characterization

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dispute. Thus, the percentage offered was not relevant to Biedenharn's holding purpose. The relevant percentage would have been real estate sales profits compared to total income from the land (which would include, *e. g.*, income from farming or leasing the land).

A second situation in which a percentage is relevant involves a taxpayer attempting to demonstrate that certain parcels of land were held for purposes other than for sale. This taxpayer could concede that he was in the real estate development business, but would argue that certain specific parcels of land were not held "primarily for sale." *See, e. g. Wood v. Commissioner*, 276 F.2d 586 (5th Cir. 1960); *Maddux Construction Co.*, 54 T.C. 1278 (1970); *Randolph R. Rouse*, 39 T.C. 70 (1962); *Nelson A. Farry*, 13 T.C. 8 (1949). These specific properties, he would argue, were held for other purposes. In this situation, a relevant percentage would be profits from (or number of) sales from property held primarily for sale as compared to profits from (or number of) all sales. If many of taxpayer's sales, or much of his profit, emanated from properties he claimed to hold for purposes other than "for sale," the taxpayer would be highly unlikely to establish capital gain treatment. Conversely, if a taxpayer who engaged in a high volume subdivision business sold one clearly segregated tract in bulk, he might well prevail in his claim to capital gain treatment on the segregated tract.

[25] An early example is presented by *Thomas v. Commissioner*, 254 F.2d 233 (5th Cir. 1958), in which the court first carefully removed its review of the Tax Court's legal conclusion from the constraints of the "clearly erroneous" rule, *see id.* at 236, and then proceeded to find the Tax Court's determination that the property was held primarily for sale to customers in the ordinary course of his trade or business to be "clearly erroneous." Id. at 237. For another early example, see *Smith v. Commissioner*, 232 F.2d 142 (5th Cir. 1956).

of property as "primarily held for sale to customers in the ordinary course of [taxpayer's] trade or business" is a question of law or a question of fact. This characterization is of course crucial to the outcome of many cases—if the characterization is a question of fact, the factfinder's answer must be accepted unless clearly erroneous, but, if a question of law is presented, plenary review on appeal is appropriate. Unfortunately, there are two independent lines of authority in this Circuit on this issue. One line has its genesis in *Galena Oaks Corporation v. Scofield,* 218 F.2d 217 (5th Cir. 1954), and holds that the characterization "is inherently a question of law." *United States v. Winthrop,* 417 F.2d 905, 910 (5th Cir. 1969).[26] The other line traces its roots to *Thompson v. Commissioner,* 322 F.2d 122, 127 (5th Cir. 1963), and can be followed through *United States v. Temple,* 355 F.2d 67, 68 (5th Cir. 1966) to *United States v. Burket,* 402 F.2d 426, 429 (5th Cir. 1968) and *Huxford v. United States,* 441 F.2d 1371, 1375 (5th Cir. 1971). This line holds that "the question of whether certain properties were held by a taxpayer 'primarily for sale to customers in the ordinary course of [his] trade or business' is essentially a question of fact." *Burket,* 402 F.2d at 429. *See Commissioner v. Tri-S Corp.,* 400 F.2d 862, 863 (10th Cir. 1968) (question is "essentially a question of fact"); *Maddux Construction Co.,* 54 T.C. 1278, 1284 (1970) ("question is purely a factual question").

We need not here psychoanalyze the nightmares of characterization that have fascinated professors of civil procedure: the distinctions between historical, evidentiary, subsidiary, and ultimate facts are too fine for useful discussion. Once it is perceived that the ultimate legal conclusion of capital gain or ordinary income involves several

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[26] This line includes, *inter alia, Houston Endowment, Inc. v. United States,* 606 F.2d 77, 83 (5th Cir. 1979); *Biedenharn,* 526 F.2d at 416 n.25; *Winthrop;* and *Thomas v. Commissioner,* 254 F.2d 233, 236 (5th Cir. 1958).

independent determinations, it can be easily seen that some of the determinations are predominantly legal conclusions or are "mixed questions of fact and law," whereas others are essentially [27] questions of fact. Thus, the question of taxpayer's purpose or purposes for holding the property is primarily factual, as is the question of which purpose predominates. Similarly, the "ordinariness" of the contemplated sales is mainly a fact question. The question of whether taxpayer was engaged in a trade or business involves the application of legal standards concerning what constitutes a trade or business to the facts concerning taxpayer's activities, and therefore is best characterized as a "mixed question of fact and law". The ultimate legal conclusion, based on these factual and legal conclusions, of whether the property was "held primarily for sale to customers in the ordinary course of his trade or business" cannot be appropriately characterized in this scheme at all because, as noted above, there are several subsidiary questions which, separately answered, lead to the ultimate conclusion.[28]

A. Was Suburban in the real estate business?

This is a relatively simple issue. The question is whether taxpayer has engaged in a sufficient quantum of focused activity to be considered to be engaged in a trade or business. The precise quantum necessary will be difficult to establish, and cases close to the line on this issue will arise.

Happily, we need not here define that line. It is clear to us that Suburban engaged in a sufficient quantity of activity to be in the business of selling real estate. Subur-

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[27] None of the determinations appears to be a "pure" question of fact because findings such as "holding purpose" and "ordinariness" necessarily involve application of precedent to determine the import of these terms.

[28] It should be apparent that appellate review of a trial court's application of the answers to the subsidiary questions to arrive at the ultimate conclusion is plenary.

ban's sales were continuous and substantial. It completed at least 244 sales transactions over the 33-year period 1939-1971. This averages to over 7 transactions per year. Proceeds from these sales exceeded 2.3 million dollars.

Suburban does not claim to have been engaged in any business other than real estate; rather, it claims that during the periods at issue it simply "did not carry on a trade or business." Br. for Appellee at 20. Were additional support necessary for our conclusion, we would point to Suburban's own statements on its tax returns over the years that its principal business activity was "development and sales of real estate." These statements are by no means conclusive of the issue. *See Thomas v. Commissioner*, 254 F.2d 233, 236-37 (5th Cir. 1958). However, we believe they show at least that if Suburban is engaged in a trade or business, that business is real estate.[29] And Suburban's activities over the years were sufficient to convince us that it cannot sustain its contention that it was never engaged in any "trade or business" at all.

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[29] In *Thomas*, we went to some length to demonstrate that the fact that Thomas designated his occupation as a Real Estate Broker and as a Registered Real Estate Broker was not conclusive in determining the character of the holding of property of the taxpayer sold by him. *See Thomas*, 254 F.2d at 236-37. Thomas did earn brokerage commissions on sales of certain properties where his role was that of a middleman or go-between; i.e., a broker. This fact, we said, was not of great significance in determining whether dealings in property owned by the taxpayer were to be characterized as investments or as "sale[s] to customers in the ordinary course of [his] trade or business." Put otherwise, it might be said that an admission that one is a real estate "broker" does not automatically concede that one is also a "dealer" in real estate. Thomas was a real estate broker, but as to deals in which he was a principal, he successfully argued that he was an investor rather than a dealer.

Here, Suburban's argument is of an entirely different character. Suburban suggests no business other than real estate dealing, but claims that it was engaged in no business at all.

Suburban relies heavily on the insignificance of its subdivision and development activity and the total absence of any advertising or sales solicitation activity on its part. However, the first two absences do not concern us at all. We need not decide whether its subdivision and development activities were sufficient to compel the conclusion that Suburban was in the real estate development business.[30] We rely solely on Suburban's real estate business.

The presence of any sales solicitation or advertising activity would certainly be relevant to the issue of whether Suburban was in the business of selling real estate. Strenuous, but largely unsuccessful, attempts to sell might compel the conclusion that a taxpayer with very few sales transactions was nonetheless in the business of selling. But the absence of such activity does not compel the opposite conclusion. *See* p. 179, *supra; Thompson,* 322 F.2d at 126.

Suburban also seeks solace from the fact that it never purchased any additional real estate to replenish acreage it sold. As is the case with the presence of sales activity, the presence of such purchases tends to demonstrate that a taxpayer is engaged in a real estate business, but their absence is not conclusive:

> The fact that [taxpayer] bought no additional lands during this period does not prevent his activity being a business. [Taxpayer] merely had enough land to do a large business without buying any more.

Biedenharn, 526 F.2d at 417, *quoting Snell v. Commissioner,* 92 F.2d 891 (5th Cir. 1938).

Additionally, Suburban points to its commencement of an investment program in securities in 1966. By itself, this

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[30] If Suburban was ever in this business, it certainly had withdrawn by 1961, when the plats for Homestead Addition Two were withdrawn and cancelled, as no development activity had occurred since 1955.

cannot affect our conclusion that Suburban was in the real estate business. It merely demonstrates that, commencing in 1966, Suburban was also engaged in investing in securities.[31] As stated earlier, the presence of other types of activities does not prevent taxpayer's real estate activities from being considered a business.[32]

Suburban also contends that, if it was ever in the real estate business, it had exited that business long before 1968, the time of the first transaction here at issue. Even if this is true, it cannot affect our ultimate conclusion. The statutory language does not demand that property actually be sold while a taxpayer is still actively engaged in its trade or business for ordinary income treatment to be required. Rather, it demands that the property have been held primarily for sale in that business.[33] To that inquiry we now turn.

B. What was Suburban's primary purpose for holding the properties whose characterization is here in dispute?

Put into the framework being used here, Suburban's contention concerning holding purpose is two-fold. Principally, it argues that, at the time of the sales in dispute, the properties were not being held for sale. Alternatively, it contends that it "originally acquired its property as an investment . . ., and it continued to hold it for investment purposes." Br. for Appellant at 7.

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[31] We need not here reach the question of under what circumstances, if any, such investment activities would be considered a "trade or business."

[32] See n. 24, *supra*.

[33] The question of exit from a business is intimately tied to, although independent of, the "holding purpose" inquiry. Exit from active business can be strong evidence of a change in holding purpose. The holding purpose question, as well as the timing of its inquiry, are discussed immediately below.

We reject Suburban's statement of the legal principle upon which its first argument is premised. It simply cannot be true that "the decisive question is the purpose for which [the property] 'primarily' was held when sold." Br. for Appellant at 15 (emphasis omitted).[34] At the very moment of sale, the property is certainly being held "for sale." The appropriate question certainly must be the taxpayer's primary holding purpose at some point before he decided to make the sale in dispute.

There is language in the cases that supports the proposition we are here rejecting. For example, the Tax Court has stated explicitly that "the determining factor is the purpose for which the property is held at the time of sale." *Eline Realty Co.*, 35 T.C. 1, 5 (1960). *See Maddux Construction Co.*, 54 T.C. 1278, 1286 (1970).

However, neither party has cited any Supreme Court or Fifth Circuit precedent which states the proposition that the relevant holding purpose is that existing at the moment of sale. Suburban relies on *Malat v. Riddell*, 389 U.S. 569, 86 S.Ct. 1030, 16 L.Ed.2d 102 (1966) and *Fahs v. Crawford*, 161 F.2d 315 (5th Cir. 1947). *Malat* does not address this issue at all, but concerns the meaning of the word "primarily" in 26 U.S.C. § 1221(1). *See* 389 U.S. at 571-572, 86 S.Ct. at 1032. *Fahs* merely acknowledges the possibility that a taxpayer's holding purpose for an asset may change, *see* 161 F.2d at 317, a concept we wholeheartedly approve. The Government points to *Ridgewood Land Co., Inc. v. Commissioner*, 477 F.2d 135 (5th Cir. 1973) (per curiam). There, as in *Fahs*, we see no more than a holding that a taxpayer's purpose for holding an asset may change, so that his intentions at the time of acquisition of the asset

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[34] We note that the Government also adopts this position. Br. for Appellee at 45.

do not control the characterization of the proceeds of its sale. *See* 477 F.2d at 136.[35]

Actually, although we are exceedingly hesitant to tell other courts that they do not mean precisely what they have said, the Tax Court cases cited above are not inconsistent with our approach. In *Eline Realty, supra,* the court found that taxpayer's holding purpose for the particular parcel at issue changed "from one of sale to one of investment" long before the parcel was sold. *Id.,* 35 T.C. at 6. Similarly,

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[35] Suburban also cites *Commissioner v. Tri-S Corp.,* 400 F.2d 862 (10th Cir. 1968), in support of its contention. *Tri-S* adopts our approach to this problem. The taxpayer there purchased land on October 10, 1960 and sold it on October 6, 1961. The court found that prior to April 7, 1961, the taxpayer had intended to improve the land. On that date, the State of Colorado notified the taxpayer that part of the land would be condemned. From April 7, the court found, the taxpayer was not holding the land primarily for sale to customers in the ordinary course of its trade or business. Thus, it was not holding the land for sale to customers in the ordinary course of its trade or business on July 25, 1961, when it agreed to sell the land, or October 6, 1961, the date of the conveyance.

We caution that our agreement with the Tenth Circuit on the question of the timing of the holding purpose inquiry should not be understood to indicate our agreement with its ultimate conclusion. If external events change the holding purpose for certain property from "for sale" to "for investment," we might well still find that the gains were ordinary because the property had been acquired and held "primarily for sale to customers in the ordinary course of [taxpayer's] trade or business." Conversely, as indicated in *Biedenharn,* an initial purpose to hold for investment might "endure[] in controlling fashion notwithstanding continuing sales activity." *Biedenharn,* 526 F.2d at 421. As noted there, such an opening would most generally exist "where the change from investment holding to sales activity results from unanticipated externally induced factors which make impossible the continued pre-existing use of the realty." *Id.* On the facts of *Tri-S,* we might well have concluded that taxpayer was "wholesaling" property held "primarily for sale to customers in the ordinary course of his trade or business," so that ordinary income treatment would be appropriate. This "wholesaling niche" would be the converse of the "liquidation niche" left open by *Biedenharn.*

Maddux Construction, supra, stands for the proposition that a taxpayer can abandon prior to sale his initial purpose for acquiring the property. *Id.,* 54 T.C. at 1286.

The "holding purpose" inquiry may appropriately be conducted by attempting to trace the taxpayer's primary holding purpose over the entire course of his ownership of the property. *See Malat v. Riddell,* 383 U.S. 569, 86 S.Ct. 1030, 16 L.Ed.2d 102 (1966); *Devine v. Commissioner,* 558 F.2d 807 (5th Cir. 1977).[36] Thus, the inquiry should start at the time the property is acquired. We seek to divine the taxpayer's primary purpose for acquiring the property. In this case, we are willing to assume, as Suburban argues, that the property was acquired principally as an investment.[37] We then seek evidence of a change in taxpayer's primary holding purpose. Here, such evidence is plentiful and convincing.

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[36] It is not clear to us from the *Malat* decision whether "primarily" means "predominates at a certain point of time" or "predominates over the life of taxpayer's ownership of the asset." This could be critical if, for example, a taxpayer held a piece of property primarily for sale over many years, but then, shortly but not immediately before sale, switched his primary holding purpose to one of investment. If the appropriate measure of "primarily" is at a fixed instant of time, this taxpayer would be entitled to capital gain treatment if the other requirements of § 1221 are met. However, taxpayer's "primary holding purpose" over the length of his ownership of the asset would still be "for sale," and, if this is the proper test, ordinary income treatment would be mandated.

We express no opinion on the resolution of this issue, for it is unnecessary to our decision. We find Suburban's primary holding purpose to be "for sale" both at the relevant moment of time, if the first proposed test is appropriate, and over most of the period of Suburban's ownership of the property, if the second proposed test is appropriate. *See* ensuing discussion in text.

[37] There is considerable evidence to the contrary. Suburban's corporate charter clearly contemplates an active real estate business rather than passive investment status. This is not conclusive, because "the exercise of a [corporate] power and not the possession of it is the material factor to be weighed in testing whether a cor-

The property was acquired in December, 1937. Houston Gardens Annex, Inc. was formed in 1938 to plat and sell a portion of the property. Sales commenced by 1939, and sales were transacted in each year thereafter. From 1946 through 1956, approximately 17 sales per year occurred. Proceeds from sales exceeded $8,500 each year and were as high as $69,000 (in 1952). Also during this period, the development activity pertaining to Homestead Addition Two was occurring. *See* pp. 175-176, *supra*. This development activity clearly contemplated, and was accompanied by, sales.

All of these factors convince us that, by the mid-1940's at the latest, and probably much earlier, Suburban's primary holding purpose was "for sale." We need not decide the precise moment. Were it necessary to our decision, we quite likely would be unwilling to accept Suburban's contention that the property was initially acquired for investment. *See* n.37, *supra*.

With its primary holding purpose through the 1940's and 1950's fixed at "for sale," Suburban is then entitled to show that its primary purpose changed to, or back to,

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poration is in a particular business." *Alabama Mineral, supra*, 250 F.2d at 872. More importantly, Suburban's activities, commencing soon after acquisition of the property, are convincing evidence that it did not originally acquire the property primarily for investment. Thus, the same facts which convince us that any initial investment holding purpose was soon overborne by Suburban's desire to sell, *see* discussion in text, also make us highly skeptical of Suburban's claim to have initially intended to hold the property primarily for capital appreciation. The trial court adopted this theory, stating "the pattern of [Suburban's] acquisition and subsequent activities indicates that the plaintiff never had any other idea than to periodically sell the property to its cusotmers." In future cases, we would expect such fact findings to be followed unless clearly erroneous. We are reluctant to follow that course here because of the extreme confusion the cases have previously exhibited concerning what is fact and what is law in this area. *See* pp. 180-181, *supra*.

"for investment." Suburban claims that this shift occurred either in 1959, when its officers and directors discussed liquidation; in 1961, when Rice University became a stockholder of Suburban, further liquidation discussions were held, and the plats were withdrawn; or, at the latest, in 1966, when further liquidation discussions were held and Suburban began investing in securities.

We view this determination to be a closer call than any of the others in this case. The frequency of sales did drop off after the late 1950's. Suburban had discontinued its development activities.[38] Also, 1961 was the year the plats for Homestead Additions Three and Four were withdrawn.

This withdrawal of plats could be quite significant. Unlike liquidation discussions,[39] which were apparently a

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[38] These two factors are probative of a changed holding purpose, as they tend to demonstrate a different corporate attitude towards the real estate. They are not conclusive of this issue, however. *See* pp. 178-179, *supra*, and nn. 40 & 42, *infra*.

[39] We attach no independent significance to "liquidation discussions." As we said in *Biedenharn*, "a taxpayer's claim that he is liquidating a prior investment does not really present a separate theory but rather restates the main question . . . under scrutiny." *Biedenharn*, 526 F.2d at 417.

As noted *supra* n. 9, Suburban uses the term "liquidation" to refer to discussions about winding up Suburban as a corporate entity and distributing its assets, as well as discussions about converting its investments into cash. Discussions about each of these matters may evidence a change in holding purpose, but a corporation's actions may speak louder than "its" words. The latter is the case here. When investigating a corporation's intent, courts must be skeptical of words spoken at board meetings.

Although Suburban uses the word "liquidation" in an effort to place itself in *Biedenharn's* "liquidation niche," *Biedenharn*, 526 F.2d at 417, that concept is not applicable here. Rather, it refers to the possibility that a holding purpose other than "for sale" might be found to continue through a period of relatively substantial sales activity when "unanticipated, externally induced factors . . . make impossible the continued pre-existing use of the realty." *Id.* at 421.

dime a dozen for Suburban, withdrawal of the plats was an action taken by Suburban which may evince a different relationship to its land. The critical question is whether this withdrawal indicated that henceforth the land was being held principally as an investment or simply showed that Suburban was attempting to maximize sales profits by selling to commercial users.

The continuing sales activity is strong evidence that the latter interpretation is the correct one.[40] Moreover, the trial court found that the withdrawal evinced "an attempt to maximize profits from the sale of real estate and to capitalize on the new North Loop Freeway which would cross [Suburban's] property."[41] Thus, we conclude that Suburban's primary purpose for holding the property remained "for sale" at the time of the transactions here disputed.[42]

Suburban does not explicitly contend that its primary purpose for holding the specific parcels at issue here was

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[40] The average number of annual sales over the period 1961-1971 remained in excess of three.

[41] Like Suburban's initial primary holding purpose, its primary holding purpose at this time is an issue of fact on which the trial court's findings must be accepted unless clearly erroneous. We have undertaken a somewhat stricter review because of the confusion noted above. *See* pp. 180-181 and n. 37, *supra*.

[42] Some of our skepticism over Suburban's claim to have changed its holding purpose stems from the fact that it points to so many separate times when its purpose may have changed. This leads us to believe that Suburban was merely gradually shifting its strategies as market conditions changed in an effort to maximize sales profits. We do not reject outright the possibility that a sequence of events separate in time may indicate a gradual change in holding purpose from "for sale" to "for investment." However, we would be more likely to find a "change of purpose" argument convincing of zero's in the annual sales column figures, especially if this were followed by a sale of the remainder of taxpayer's property in a small number of transactions.

different from its purpose for holding the property as a whole. However, it does attempt to rely to some degree on the lack of development activity relating to the parcels here at issue. Although in some circumstances a taxpayer in the real estate business may be able to establish that certain parcels were held primarily for investment, *see* n.24, *supra* and cases cited, the burden is on the taxpayer to establish that the parcels held primarily for investment were segregated from other properties held primarily for sale. The mere lack of development activity with respect to parts of a large property does not sufficiently separate those parts from the whole to meet the taxpayer's burden. *Cf. Houston Endowment,* 606 F.2d at 81 (pattern of sales activity with respect to entire tract determines characterization of individual sales). The lack of development activity with respect to the parts of the property here at issue is at least equally consistent with a primary motivation to maximize immediate sales profits as it is with a primary motivation to hold for investment.

C. Were the sales contemplated by Suburban "ordinary" in the course of Suburban's business?

We need say no more on this question than quote from the discussion of this issue in *Winthrop, supra*:

> The concept of normalcy requires for its application a chronology and a history to determine if the sales of lots of customers were the usual or a departure from the norm. History and chronology here combine to demonstrate that [taxpayer] did not sell his lots as an abnormal or unexpected event. [Taxpayer] began selling shortly after he acquired the land; he never used the land for any other purpose; and he continued this course of conduct over a number of years. Thus, the sales were . . . ordinary.

417 F.2d at 912. The same is true here.

V.

Having relied on the language of § 1221 itself to determine that the assets here at issue were not capital assets, we must return for a moment to the query posed at the outset. In this case, as we have demonstrated, sales of the type here in dispute were precisely what Suburban's business was directed towards. In other words, the profits garnered from these sales arose from the ordinary operation of Suburban's business.

At the same time, however, these profits did not arise principally from the efforts of Suburban. Rather, they arose from the same historical, demographic, and market forces that have caused the City of Houston to grow enormously during the years Suburban held the land. Shrewdly, Suburban held on to much of its land. It only sold relatively small portions year by year. Thus, by 1968, market forces and the location of the North Loop Freeway had driven up the value of Suburban's land.[43] We must decide whether the policies motivating lower tax rates on capital gains and the controlling precedents expressing those policies require that we ignore the plain language of § 1221 and hold for Suburban.

The key cases we must explore here number three. First is *Malat v. Riddell*, 389 U.S. 569, 86 S.Ct. 1030, 16 L.Ed.2d 102 (1966) (per curiam). It lends us no aid. As we have

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[43] Suburban's evidence demonstrated that the normal net profit on sales by a developer is approximately thirty-three percent, whereas Suburban's profit on the sales here in issue approximated ninety-five percent. Since Suburban did nothing to enhance the value of the parcels here at issue, and since we can take notice of the often rapid rise in real estate prices as cities expand, we accept Suburban's contention that its profits on these sales emanated from market forces and Suburban's patience rather than any other value-enhancing activities performed by Suburban.

previously stated,[44] it suggests that profits cannot arise from both "the [ordinary] operation of a business" and "appreciation in value accrued over a substantial period of time." Yet here we have profits which fall squarely into both categories.

We thus turn to the two cases from which the *Malat* court quotations are taken, *Commissioner v. Gillette Motor Transport, Inc.*, 364 U.S. 130, 80 S.Ct. 1947, 4 L.Ed.2d 1617 (1960), and *Corn Products Refining Company v. Commissioner*, 350 U.S. 46, 76 S.Ct. 20, 100 L.Ed. 29 (1955). In *Gillette*, the Supreme Court said:

> This Court has long held that the term "capital asset" is to be construed narrowly in accordance with the purpose of Congress to afford capital-gains treatment only in situations typically involving the realization of appreciation in value accrued over a substantial period of time, and thus to ameliorate the hardship of taxation and the entire gain in one year.

364 U.S. at 134, 80 S.Ct. at 1500. We note that the quoted language does not state that all gains emanating from appreciation in value over a substantial period of time are to be treated as capital gains. Rather, it states the logical converse of that proposition; *i. e.*, that capital gain treatment will be proper only if the gain emanates from appreciation in value. Instances of gain emanating from appreciation being treated as ordinary income are not inconsistent with this proposition.

We also note the Supreme Court's recognition of the attempt by Congress to avoid taxing income earned over a period of years in one year. In Suburban's case, although it is true that with respect to each individual parcel of land there is a "bunching" effect, taxation of the overall gains from the property as a whole has been spread

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[44] *See* p. 173 *supra*.

over a long period of years. Thus, the "bunching" effect has been minimized. Last, we note the Supreme Court's admonition to construe the term "capital asset" narrowly. *Id.*

Further support for a narrow construction of the term "capital asset" and a broad interpretation of its exclusions comes from *Corn Products,* the third key case in this area. *See Corn Products,* 76 S.Ct. at 24. More importantly, the Supreme Court in *Corn Products* squarely stated:

> Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss.

Id. It is this type of profit that is before us today.

We thus conclude that § 1221(1) should be construed in accord with its plain meaning, and that, if the other requirements of § 1221(1) are met, when the ordinary business of a business is to make profits from appreciation in value caused by market forces, these profits are to be treated as ordinary income. Such is the case here.

VI.

Our journey over, we have nothing more to add. The decision of the district court dismissing Suburban's complaint is AFFIRMED.

APPENDIX

Date	Number Commercial Sales	Number Residential Sales	Total Number Sales
1939	4	0	4
1940	3	?*	3 + *
1941	1	?	1 +

* Records incomplete for 1940-1945.

Date	Number Commercial Sales	Number Residential Sales	Total Number Sales
1942	2	?	2 +
1943	1	?	1 +
1944	3	?	3 +
1945	5	?	5 +
1946	11	6	17
1947	3	12	15
1948	0	21	21
1949	3	6	9
1950	6	46	52
1951	1	6	7
1952	4	14	18
1953	2	6	8
1954	0	5	5
1955	1	16	17
1956	1	6	7
1957	1	1	2
1958	1	3	4
1959	3	1	4
1960	1	0	2
1961	2	0	2
1962	1	0	1
1963	4	0	3
1964	6	0	4
1965	4	0	6
1966	7	0	5
1967	4	0	4
1968	1	0	3
1969	4	0	3
1970	1	0	1
1971	4	0	4
TOTAL	95	149 +	244 +

APPENDIX B

APPENDIX B

[¶ 9547]

U.S. DISTRICT COURT, SOUTHERN DISTRICT TEXAS

Civil No. 75-H-1207, 7/5/77

SUBURBAN REALTY COMPANY, *Plaintiff*

v.

UNITED STATES OF AMERICA, *Defendant*

Gerald W. Haddock, Albright and Jaworski, 8th Floor, Bank of the Southwest Building, Houston, Tex. 77002, for plaintiffs. Anna E. Stool, Assistant United States Attorney, Houston, Tex., Howard A. Weinberger, Department of Justice, Dallas, Tex. 75202, for defendants.

Findings of Fact and Conclusions of Law

JONES, JR., District Judge: This matter having come on for trial before the Court, sitting without a jury, and the Court having considered the pleadings and the evidence, in accordance therewith and pursuant to the provisions of Rule 52 of the Federal Rules of Civil Procedure, the Court finds and concludes as follows:

Findings of Fact

1. This is a suit for refund of federal income taxes in the amount of $102,754.68 for the plaintiff's fiscal years ending October 31, 1969, October 31, 1970, and October 31, 1971. On October 29, 1972, the plaintiff filed claims for refund for each of these years, which claims were disallowed by action of the Internal Revenue Service on August 9, 1973. Following the notice of disallowance within the time permitted by law, plaintiff filed this action.

2. Plaintiff, Suburban Realty Company, is a corporation organized under the laws of Texas on November 5, 1937,

with its principal place of business in Houston, Harris County, Texas. Defendant is the United States of America.

3. Plaintiff's corporate charter states that it was formed to erect or repair any building or improvement, and to accumulate and lend money for such purposes, and to purchase, sell, and subdivide real property, and to accumulate and lend money for that purpose.

4. On December 7, 1937, the plaintiff acquired an undivided one-fourth interest in 1,742.6 acres of land (the property) located at what is now the intersection of Homestead Road and the North Loop in Harris County, Texas. The plaintiff acquired its portion of the property in exchange for all of its stock. It acquired the property from Mr. R. L. Blaffer, Mr. Joe Evans, Mr. S. P. Farish, and Mr. Will Farish, who had in turn acquired the property in a foreclosure proceeding against the property as a result of a default in payment of bonds. The remaining three-fourths undivided interest in the property was owned by a Mr. George Hamman and Mrs. Mary Alice Talbot. Suburban Realty was specifically formed to acquire its interest in the property.

5. Commencing with its acquisition, the plaintiff, joined by Mr. Hamman and Mrs. Talbot and their successors, began to sell parcels of real estate out of the property. Beginning with December 31, 1938, and through the end of its 1971 fiscal year the plaintiff made more than 244 individual sales of real estate out of the property. Of these, approximately 95 sales were of unplotted and unimproved property legally suitable for commercial or any other purposes and more than 149 sales were from platted property limited to residential development. Records for 1940 through 1945 are incomplete with respect to residential sales, but are indications that some residential sales were made in each of those years.

6. Throughout the period from the first sale on December 31, 1938, through plaintiff's fiscal year ending in 1971, it received proceeds (including cash and notes) from the sale of real estate of $2,353,935 and proceeds from all other sources of income, including interest on real estate sales, in the amount of $474,845. The proceeds from the sales of property legally suitable for commercial or any other development constituted 74 percent of plaintiff's income for that period, the proceeds from the sales of real property suitable for residential development constituted 9 percent and all other income, including interest on real estate notes, constituted 17 percent of taxpayer's total proceeds for that period.

7. Most of the property that was sold was never put to any other substantial use except for its anticipated ultimate disposition for sale to others. There was a grass lease which generated small amounts of income in many years. Plaintiff has engaged in during its entire corporate existence only minimal activities other than the sale of real estate. These include four years (1953 through 1956) in which it sold approximately 11 houses due to the insistence of an individual. In addition, the plaintiff sold $11,938.99 of lumber in a lumberyard which it maintained primarily for the purpose of building the aforementioned 11 houses. Plaintiff also had dividend income over the years of $54,165.25, reflecting investment of real estate proceeds, and rent and lease income of $15,732.45.

8. In 1938 plaintiff and the other owners of the property organized Houston Gardens Annex, Inc., to develop a portion of the property in the northeastern quadrant of the 1,742.6 acres. Plaintiff transferred one-quarter of such portion of the property in exchange for one-quarter of the common stock of Houston Gardens. Such land, which was then owned by Houston Gardens, was put into subdivisions and sold by lots. In 1961 Houston Gardens was liquidated.

Houston Gardens was a separate corporation of which plaintiff owned 25 percent of the outstanding stock.

9. The sales of houses and the lumberyard referred to above were both in connection with residential development of another area in the northern half of the 1,742.6 acres, Homestead Addition Number 2. This development was undertaken by plaintiff alone. This residential area was developed into some 256 lots in connection with the eleven houses and lumberyard referred to above and installation of a water and sewer system. However, by 1961 the water and sewer system was sold to the City of Houston and the utility corporation maintaining it was liquidated. The lumberyard was sold in 1961 or 1962, by which time it had been dormant for some years. No houses were built after 1955.

10. Prior to 1961 the plaintiff had filed plats with the City of Houston covering still other areas in the center of the 1,742.6 acres (called Homestead Addition Numbers 3 and 4), but had not yet developed them. In 1957 the State Highway Department proposed that the limited access super highway now known as the North Loop would be located from east to west across the 1,742.6 acres. This decision was made public pursuant to law and advertised in the Houston newspapers. Two or more parcels of property were sold by the plaintiff to the Texas Highway Department for purposes of construction of this highway in 1959 and 1960. In 1961 plaintiff withdrew the residential plat then on file with the City of Houston and proceeded to sell the property within that area for commercial or industrial purposes.

11. It is well known in the City of Houston at and about 1961 that sales for commercial purposes in areas having freeway access or closely adjacent to freeways would bring higher prices than sales for residential purposes. Therefore, this Court finds that the withdrawal of the residential plat in 1961 is not evidence of any motive to get out of

the real estate sales business, but was, rather, an attempt to maximize profits from the sale of real estate and to capitalize on the new North Loop Freeway which would cross plaintiff's property.

12. Plaintiff reported each of the sales of real estate (both those suitable for commercial and residential development) on its tax returns for its fiscal years ending in 1939 through 1971 under the column "Gross Receipts or Gross Sales" and deducted therefrom items denominated "Cost of Goods Sold" reflecting the balance as "Gross Profit." Plaintiff did not report any of the sales for the 33-year period between 1939 and 1971 as gains from the sales of capital assets. Plaintiff stated on its tax returns that it was in the business of "real estate' or "real estate development and sales."

13. Plaintiff sold nine parcels of real estate in the three years under consideration which it reported on its tax returns as ordinary income. Plaintiff now claims that the sales of real estate in 1969, 1970, and 1971 were from the disposition of capital assets. The Government agreed with the plaintiff's position on the last three of the sales, but denied plaintiff's claims for the first six, contending that these proceeds were from the sales of property held for sale to plaintiff's customers in the ordinary course of its trade or business.

14. Any conclusion of law deemed to be finding of fact is hereby adopted as the same.

Conclusions of Law

1. This Court has jurisdiction of the subject matter and of the parties. Venue is proper and this lawsuit is properly brought in this Court.

2. A single issue is presented by this lawsuit: Whether six properties sold by the plaintiff in 1969, 1970, and 1971

qualify for capital gains treatment, i. e., are to be taxed at one-half the normal corporate rate of taxation. This, in turn, depends upon whether plaintiff meets the definition of capital assets contained within Section 1221 of the Internal Revenue Code of 1954 (26 U. S. C.). That definition defines a capital asset which qualifies for capital gains treatment as property held by a taxpayer, except for "property of a kind which would properly be included in the inventory of the taxpayer * * * or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business; * * *." Thus, the specific question which the Court must answer is whether the six properties sold in the years at issue were held by the plaintiff primarily for sale to customers in the ordinary course of its business.

3. In compliance with the recent Fifth Circuit decisions of *United States v. Winthrop* [69-2 USTC ¶ 9686], 417 F. 2d 905 (1969), and *Biedenharn Realty Co. v. United States* [76-1 USTC ¶ 9194], 526 F. 2d 409 (1976), this Court concludes that the plaintiff did hold the property primarily for sale to customers in the ordinary course of its business.

4. There is little question but that from the date the property was acquired in 1937 the plaintiff's sole motivation in acquiring and holding the property was to periodically dispose of it for the best price it could get. The property was never used for any other substantial purpose, it was not converted from any use, and no exterior events took place which rendered it unfit for an originally anticipated use other than being held for sale. Instead, the pattern of its acquisition and subsequent activities indicates that the plaintiff never had any other idea than to periodically sell the porperty to its customers.

5. The conclusion that the property was primarily held for sale to customers brings us to an examination of whether such sales were made in the ordinary course of plaintiff's trade or business. Some 83 percent of the total

proceeds over 33 years were directly connected with the sales of real estate (and additional monies were indirectly connected with such sales by virtue of being interest on real estate loans), and the numbers, substantial nature, the continuity of such sales, and comparison of such sales to its other economic activities convince the Court that, indeed, Suburban had no other trade or business except for the sales of the property in question.

6. This Court has also considered the fact that Suburban did not engage in advertising, solicit sales, or even develop the commercial—as opposed to the residential segment of its property. However, the evidence has established that Suburban was successful in its sales by virtue of being continuously bombarded by inquiries from real estate agents and potential users. Suburban's business, when examined in view of its corporate charter and its nonreal estate activities, reflects that the sale of its real estate was by far the predominant economic activity in which it engaged in all but a few of the 33 years which the Court has considered. Because the vast proportion of its income was from the sale of real estate, the vast proportion of its expenses was in relation to those parcels of real estate and because of the significant and continuing nature of real estate transactions, this Court holds that plaintiff's regular business was the sale of the land in question. These parcels of real estate were not sold in abnormal or unexpected events. Suburban began selling shortly after it acquired the land, and never used the land for any other purpose and it continued this course of conduct over 33 years. Thus, the sales were not only ordinary, they were the sole object of Suburban's business.

7. Accordingly, this Court holds that Suburban held the six parcels of real property sold in the years in question for sale to its customers in the ordinary course of its trade or business. Accordingly, these sales cannot qualify for capital gains treatment and Suburban must pay the ordi-

nary income tax on their sale. The Government is entitled to prevail on the issue presented in this lawsuit.

8. If any finding of fact is deemed to be a conclusion of law, it is hereby adopted as the same.

The parties are hereby directed to prepare a judgment in conformity with these findings of fact and conclusions of law and submit it to the Court for entry.

APPENDIX C

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 77-3094

D. C. Docket No. CA 75-H-1207

SUBURBAN REALTY COMPANY,
Plaintiff-Appellant,

v.

UNITED STATES OF AMERICA,
Defendant-Appellee.

Appeal From the United States District Court for the Southern District of Texas

Before: GOLDBERG, FAY and ANDERSON, Circuit Judges

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this Court that the Judgment of the said District Court in this cause be, and the same is hereby, affirmed;

IT IS FURTHER ORDERED, that the Plaintiff-Appellant pay to the Defendant-Appellee the costs on Appeal, to be taxed by the Clerk of this Court.

April 7, 1980

ISSUED AS MANDATE: April 29, 1980

APPENDIX D

APPENDIX D

SUPREME COURT OF THE UNITED STATES

No. A-54

SUBURBAN REALTY COMPANY,
Petitioner,

v.

UNITED STATES

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI

UPON CONSIDERATION of the application of counsel for petitioner(s),

IT IS ORDERED that the time for filing a petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including August 15, 1980.

/s/ LEWIS F. POWELL, JR.
Associate Justice of the Supreme Court of the United States

Dated this 17th day of July, 1980.